Macroeconomic Developments in Serbia

May 2020
Sustained Macroeconomic Stability

• In six years, Serbia has transformed to a low inflation and stable growing economy, with a balanced fiscal position, declining public debt, significantly reduced external imbalances and labour market recovery, which helped our economy to respond readily to ongoing challenges.

• COVID-19 and global recession will have a less severe impact than in other European countries, due to strong pre-crisis fundamentals (macro stability, growth momentum, fiscal space), large and timely monetary and fiscal package, favourable structure of the economy and timely implementation of lockdown measures which allowed earlier easing of some restrictions.

• Inflation has moved in accordance with our expectations, and in April it measured 0.6% y-o-y. Low inflationary pressures are also confirmed by the core inflation of 1.4%, as well as by anchored inflation expectations. Inflation is expected to average 1.5% and 1.8% in 2020 and 2021, respectively.

• GDP growth in 2019 continued with strong economic expansion reaching a rate of 4.2%, driven by investments. The trend continued in Q1 2020 with growth estimated at 5%, despite first effects of COVID-19. Pandemic effect on the economy will peak in Q2, but we expect fully recovery by the end of the year.

• The adopted fiscal policy measures (EUR 5.1 bn, around 11% of GDP) will allow GDP to return to pre-crisis levels by the end of the year and sustainable growth of around 4% in the medium term. In May, Government issued a 7Y Eurobond of EUR 2 bn, at an interest rate of 3.375% (coupon rate 3.125%), while public debt is estimated to remain below the Maastricht criteria of 60% of GDP. Public debt stood at 51.9% of GDP in March.

• CAD is set to decline to 5% of GDP in 2020. Macroeconomic stability and business environment improvements contributed to high FDI inflows of EUR 7.3 bn in 2018–2019. Strong FDI inflow continued in Q1 2020 (7.4% of GDP).

• Unemployment rate reached the lowest level in 2019, while employment rate reached the highest comparable level.

• Results were acknowledged by confirmed credit ratings in 2020 (Fitch and S&P) despite global crisis caused by COVID-19 pandemic. In 2018, a PCI arrangement with the IMF has been approved, with successfully completed 3rd review.

• In May, NBS decided to keep the key policy rate at 1.5%, having in mind the undertaken monetary policy measures aimed at mitigating the economic fallout from the coronavirus (COVID-19), whose effects will be largely manifested with further resumption of economic activity.

• Credit activity extended its steady and sustainable growth in 2020, which in March accelerated to 11.9% y-o-y.

• Banking sector stability has been preserved and further reinforced. Encouraged by the NBS measures, the share of NPLs in total loans declined to 4.0% at end-March 2020. Capital adequacy indicators are even stronger after the application of Basel III standards in Serbia.
Inflationary Pressures Remain Low Due to Lower Aggregate Demand and Global Oil Prices

Inflation profile similar to advanced economies...

- Inflation is kept firmly in check, moving around 2% on average in the past six years.
- As a result of sharp decrease of oil prices, which reflected on lower prices of oil derivatives, and base effect in vegetable prices, inflation slowed to 0.6% y/y in April.
- The biggest positive contribution to inflation came from service and processed food prices (each 0.7 pp) as well as prices of cigarettes and fruits (each 0.3 pp).
- The biggest negative contribution came from prices of vegetables (-1.0 pp) and oil derivatives (-0.7 pp).

... same stands for core inflation

- Average core inflation in the last six years stood at 1.4%, confirming price stability.
- Driven by one-off price increase of phone services and travel packages prices, core inflation stood at 1.4% in April.
- In following period we expect core inflation to remain on a similar level.
- Inflation expectations are stable and moving in the lower half of the target tolerance band (May 2.2% Bloomberg survey)
Inflation Stable Within the Target in the Medium Term

Inflation will hover around the lower bound of the target tolerance band in the period ahead…

...and will gradually approach the target midpoint from the H2 2021

• Inflation is expected to return within the tolerance band in the mid-2020, and will hover around the lower bound of the target tolerance band in the next four quarters, and gradually approach the target midpoint thereafter.

• Risks of the projection are judged to be symmetric and related mainly with trends in the international environment, primarily global trade and economic growth, capital flows to emerging economies and the global prices of oil and other primary commodities. The movement of inflation will also depend on the pace of recovery of domestic demand and administered prices.

• In the short run, inflation profile will be driven by the low base effect from vegetable prices, which will lead to inflation`s return within the tolerance band in the mid-2020, while low petroleum product prices will act as a dumper.

• Disinflationary pressures, that prevail in the medium run, will come from notable drop in oil prices, low domestic and external demand, as well as low import inflation.
Minimal Effects of COVID-19 on Q1 Growth

Industry, infrastructure projects and services remained main drivers of growth in Q1

- After slowdown in economic activity in H1 2019 due to negative external effects and temporary decline in industrial production, GDP growth picked up in H2, reaching 6.2% in Q4 2019.
- Growth continued in similar pace in Q1 2020, reaching estimated rate od 5.0% driven by high growth of industrial production, continuation of investment projects, and stable service growth, despite Covid-19 pandemic.
- As in most of other countries, we expect to see effects of the pandemic largely in Q2, with V shape recovery thereafter.

GDP growth led by fixed investment and sustainable consumption growth

- In the last two years, around 80% of growth came from fixed investment, adding on average 3.5 pp to annual growth.
- Consumption remained as planned, growing slower than the overall GDP, further improving the structure of the economy.
- In Q1 2020 growth relied, on domestic demand, predominantly fixed investment, with negative contribution coming form net exports.
Minimal GDP Decline of 1.5% in 2020, Followed by Growth of Around 6% in 2021

GDP growth in 2019 surpassed expectations despite external challenges

Chart 7 GDP developments
(y/y growth rates in % and contributions in pp)

- Despite momentum loss across much of the Eurozone, and negative contribution of one-off effects, GDP growth in 2019 surpassed our expectations, reaching 4.2%, primarily driven by faster growth of fixed investment.
- Net exports contribution remained negative, but less that in previous year, due to improvements in exports. Additionally, the main driver of imports growth was equipment imports related to growing fixed investment.
- Personal consumption continued to grow slower that the GDP, despite increase in wages, pensions and other key sources.

In the coming years Serbia will maintain a strong, sustainable and broad-based growth

Chart 8 GDP growth projection (from May 2020 IR)
(y/y growth rates, in %)

- Before the Covid-19 pandemic, growth in 2020 was expected to remain around 4%. However the coronavirus spread and necessary health measures will slow down the economy in Q2, especially hitting the service sectors.
- Taking into account comprehensive, large and timely package of monetary and fiscal measures, we expect a quick recovery after Q2 (V shape).
- We project that GDP will decline at a lowest rate in Europe of 1.5% in 2020, followed by strong growth in 2021 of around 6%. In the medium-term we expect to return to stable growth pace of around 4%.
# Programme of Economic Measures to Mitigate the Negative Effects Caused by the COVID-19 Pandemic and Support the Serbian Economy

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The Ongoing Investment Cycle

Preceded by achieved macroeconomic stability, new investment cycle began in 2015…

…supported by diversified financing sources

- In 2015-2019, fixed investments grew at an average annual rate of about 10%, while their cumulative growth was about 63%.
- The fastest growth was made in 2018 and 2019, when fixed investments increased in real terms by 17.8% and 16.4%.
- The share of fixed investment in real GDP increased from 17.5% in 2014 to 24.3% in 2019, and it is expected to continue to rise, with a temporary crunch in 2020 due to negative effects of the Covid-19 pandemic.

- In earlier years, investments have largely relied on FDI.
- Owing to maintained macroeconomic and financial stability, exchange rate stability, as well as fiscal consolidation, in recent years we gained three more strong pillars for financing investments: multiplied profitability of the economy, investment credits and doubled government investments.
- On top of that, FDI inflow reached record levels of around 8% of GDP.

Chart 9 Fixed investment share in GDP
(real terms, in % of GDP)

*NBS estimate

Chart 10 Key sources of investment financing
(in EUR mln)
Macroeconomic and Financial Stability Supported High FDI Inflow

Macroeconomic and financial stability combined with structural reforms has created a favourable climate for FDIs…

...which are diversified by sector and origin and contributing to the country’s export potential

• Out of a gross inflow of EUR 7.3 bn (EUR 6.7bn net) in 2018 and 2019, EUR 4.1 bn has been directed into tradable sectors, most notably manufacturing (EUR 1.9 bn).

• Manufacturing sectors with the highest FDI inflows (metals, autos, food, tyres) recorded a high growth in employment, output and exports.

• Serbia ranked first on Financial Times Greenfield FDI Performance Index for 2019.

• During Q1 2020 FDI remained strong despite the corona virus pandemic, with net inflows (7.4% of GDP) growing 3.7% y/y.

• FDI inflows are diversified by region of origin as well, with a greater share of countries from the Asia Pacific and Middle East regions, alongside Serbia’s major investment partner - the European Union.

• During 2017 – 2019, the bulk of FDI inflows still came from Euro area countries (45.1%), but with an increasing share of Asian countries (16.4%) such as China/HK and the UAE, as well as non-EU European countries (20.8%) such as Russia, Turkey and Switzerland.

Chart 11 FDI composition by sector (EUR bn)

Chart 12 FDI composition by geographic origin (EUR bn)
Current Account Deficit Set to Decline to 5.0% of GDP in 2020

CAD peaked in 2019 due to high growth in equipment imports

From a savings-investments perspective CAD increase in 2019 was driven by higher investments

- Key factors behind CAD improvement in 2020 are a contraction in domestic demand, lower oil prices and resilience of exports on account of diversification and increased production capacities (investment growth in the previous period).
- The CAD amounted to 6.9% of GDP in 2019, as a result of an increase in the share of investment in GDP and one-off factors.
- Since 2015 Serbia’s current account deficit has been fully financed by net FDI, which we expect to be continued in the coming period.

- In 2020 the decline in the S-I gap will be driven by a faster reduction of private and public investments (postponement of projects) than in public sector savings.
- Private sector savings will increase in 2020 due to reduced domestic demand and lower energy prices.
- During 2019 the share of gross domestic investments in GDP increased from 22.7% to 24.6% broadly in line with the CAD increase.
- The S-I gap since 2017 is driven by the private sector, while government savings and investments were mainly neutral (a result of the fiscal consolidation) until the pandemic.
Exports are Expected to Rebound Faster Than Imports During Pandemic Recovery

Exports will decline slightly in 2020 due to global recession, with return to previous growth path already in 2021

Imports decline will be deeper and recovery slower due to combined effect of domestic demand and energy prices

• Small decline in overall exports of goods and services in 2020 will be driven by manufacturing exports due to reduced external demand and disruption in global production and services chains.

• Services exports are expected to show more resilience due to limited share of tourism and high pre-crisis growth of less affected sectors – IT and business services.

• Despite the pandemic, exports of goods and services continued to grow in Q1 (4.6% y/y), driven by exports of services, manufactured and agricultural goods.

• The greatest reduction in imports is expected in energy and other industrial inputs due to price decline and reduced overall economic activity, as well as in consumer goods due to decline in final consumption. Imports of equipment should be relatively less affected.

• Oil price decline in will have a delayed additional effect on lower natural gas prices throughout 2021.

• As of 2017 Serbia was seeing a faster growth in imports on account of capital and intermediate goods related to investment and industrial activity, higher oil prices as well as further growth in domestic demand.
Increased Geographical Diversification of Foreign Trade

Increased exports to Germany despite the slowdown of German economy

- Serbia’s exports are largely directed towards EU and countries of the region. In 2019, about two thirds of Serbian exports went to the EU, followed by CEFTA and CIS.
- By country, the largest share of exports went to Germany (12.7%), followed by Italy (10.2%), Bosnia and Herzegovina (7.7%), Romania (5.8%) and Russia (5.0%).
- In 2019 compared to 2018, share of exports to the Italian market declined from 12.7% to 10.2%, while the share of exports to non-EU states increased.
- Although not yet among top 10, exports to China are increasing at triple digit rates.

Germany is the largest import partner with growing importance of China

- Majority of imports (around 60%) come from the EU, followed by CIS and CEFTA.
- By country, the largest shares of imports are from Germany (13.0%), China (9.1%), Italy (8.8%) and Russia (8.7%).
Labour Market Recovery and Total Factor Productivity Growth

The lowest unemployment rate in 2019

Chart 19 Labour market indicators according to the Labour Force Survey, (in %)

- The unemployment rate was at its lowest level so far in 2019 and stood at 10.4%, down 2.3 p.p. compared to the previous year.
- The employment rate in 2019 recorded the highest level of 49.0% (y/y growth of 1.4 pp).
- The increase in the number of employees also comes from a higher participation rate of 0.3 p.p. at y/y level, which in 2019 was 68.1%.

Increasing contribution of total factor productivity to Serbian GDP growth

Chart 20 Contribution of factors of production to GDP (in pp, period average)

- In the period as of 2015, a positive contribution to GDP growth came from capital, labour and TFP.
- Growth acceleration in 2017-2018 was driven mainly by faster TFP growth. Labour contribution to growth declined compared to 2015-2016, compensated by a faster growth of the capital stock.
- In the medium term, we expect still lower contribution from labour, a higher capital contribution due to structural reforms, while TFP contribution will increase further to 2 pp supporting income convergence to developed countries.
The highest level of wages at the beginning of 2020

Chart 21 Nominal net wages by economic sector (in 000 RSD)

- The average nominal net wage in the period January-February 2020 amounted to 59,037 dinars (502 euros), which is its highest level so far, and was 10.4% higher compared to the same period in 2019.
- Observed by sectors, the largest growth in the first two months of 2020 was recorded in the manufacturing and construction, as well as in private sector services.
- Private sector wage growth (10.7%) since the beginning of the year has been followed by public sector wage growth (10.5%).

Dominant contribution of industry in formal employment

Chart 22 Contribution to y-o-y growth in total formal employment by economic sector (period average, in pp)

- Although total formal employment in Q1 has slowed down its growth it increased by 1.8% y/y (i.e. 39 thousand persons).
- Favourable trends in the formal labour market come from the private sector, where employment has recorded y/y growth of 2.4%, i.e. 37 thousand persons.
- At the same time, in the public sector, the number of employees in Q1 has slightly increased for the first time since the beginning of the rationalization in 2015 (growth by about 2 thousand persons, i.e. 0.4%).
- Introduced measures of social distancing in March mostly affect the employment in service sector.
Increase in Fiscal Deficit in 2020 Due to Covid-19, Public Debt Below Maastricht Level Throughout The Year

Strong fiscal adjustment since 2015 of around 8 pp of GDP…

…resulted in a decline in the public debt-to-GDP ratio and its sustainability

- Improvement of the fiscal outlook in last four years was led by fiscal consolidation on expenditure side, and robust growth in revenues on account of GDP growth and improved tax collection.
- After two years of surplus, fiscal balance recorded deficit of 0.2% of GDP in 2019 as a result of intensive government investment, which grew by one third, reaching near 5% of GDP.
- In Q1 government recorded fiscal deficit, due to somewhat lower tax revenue and increased expenditures, particularly for medical equipment and material for fighting the pandemic.
- In the first three months public debt remained at a stable level of 51.9% of GDP (52.0% at end of 2019).
- Public debt dinarisation picked up from 20.9% (end-2016) to 28.8% in March 2020.
- The Government program for mitigation of negative effects of coronavirus will lead to increase in budget deficit and public debt. However, public debt will remain below the Maastricht criteria level of 60%.
- For the purpose of financing these measures government issued a 7y Eurobond with the amount of EUR 2bn, at an interest rate of 3.375% (coupon rate 3.125%).
- In the medium-term deficit will return to the level of around 0.5% of GDP.
Key Policy Rate Kept at 1.5%, Its' Lowest Level in The Inflation Targeting Regime

In May 2020, the key policy rate is kept unchanged at 1.5%

Chart 25 Interest rates
(in %)

22
20
18
16
14
12
10
8
6
4
2
0


The decision takes into account the following factors:

• The undertaken monetary policy measures aimed at mitigating the economic fallout from the coronavirus (COVID-19), whose effects will be largely manifested with further resumption of economic activity.

• Increased uncertainty in the international financial market, and eventually lower capital flows to emerging economies.

• The fact that our country is in a much better macroeconomic position than before.

FX required reserve ratio has remained unchanged since early 2016

Chart 26 Reserve requirement ratios
(in %)

26.0
29.0
20.0
5.0
22.0
19.0
13.0
0.0
0
10
20
30
40
50


FX <2y
RSD <2y
FX >2y
RSD >2y

• Last time FX RR ratio was reduced in early 2016 aiming to support lending activity (to 20%/13%, for liabilities up to/over 2Y).

• RR is an important monetary policy tool (in April 2020 RR amounted to EUR 2.1 bn and RSD 198.1 bn).

• NBS uses RR as an important macroprudential tool within dinarisation strategy:
  - by applying lower RR ratio on dinar vs FX sources,
  - by applying remuneration at higher rate on dinar RR vs FX RR (i.e. 0.25% on RSD RR), while no remuneration is applied on FX RR).
The Effects of Monetary Policy Easing are Reflected in Lower Costs of Government and Private Sector Financing...

Interest rates on dinar government securities have slid to new minimums …

• The dinar yield rate curve is extended to 12 years in February, with decline of yield rate on 12y dinar bond to 3.35% in March.

• The share of long-term securities (5+ year maturity), increased from 2% in December 2012 to almost 80% in 2020.

• In auction held in January 2020, Serbia issued for the first time EUR bond with the maturity of 20 years (with yield rate of 3.0%).

… while interest rates on private sector loans are close to their lowest levels

• Since the beginning of monetary policy relaxation cycle (May 2013), dinar lending interest rates fell sharply, which in March amounted to:
  - 3.6% for corporates (down by 12.9 pp)
  - 9.2% for households (down by 11.4 pp)

• The servicing costs of outstanding credit amounts have also been reduced, leading to higher disposable income for consumption and investments, of both households and corporates.

• In the observed period, a sharp fall in the country risk premium and the country’s credit rating upgrade, as well as monetary easing by the ECB contributed to the fall in EUR-indexed lending rates.
... as well as to Growth of Credit Activity

Lower costs of financing and sustainable economic growth support domestic lending ...

Chart 29. Bank lending to enterprises and households
(y/y rates, constant exchange rate 30 Sept 2014, in %)

• In 2020, lending activity recorded double digit y-o-y growth rates, which in March, excluding the exchange rate effect, accelerated to 11.9% y/y.
• The credit structure remained favourable, as the lending growth was primarily driven by corporate investment loans.
• Further growth of lending activity is expected in the coming period, as a result effects of monetary policy easing by the NBS, low interest rates in the euro area, interbank competition and reduced NPLs.

... and the positive tendencies are also reflected in corporate loans market

Chart 30. Contributions to y-o-y corporate lending growth
(in pp, constant exchange rate 30 Sept 2014)

• Since the beginning of H2 2019, corporate loans are providing the biggest contribution to y/y growth rate of total credit activity (in March over 60%) and significant support to further growth of economic activity.
• The strong increase of investment loans is providing the biggest impetus to the y/y growth rate of corporate loans (14.5% in March2020), while their amount reached almost EUR 5 bn.
• Investments loans have become the largest category of corporate loans for almost a year already (with the share of 44.9% in March 2020), followed by loans used to finance current assets (with share of 39.7% in March 2020).
Despite Global Uncertainty and Increase of Risk Aversion Dinar Stayed Broadly Unchanged

The rise of risk premia due to the global uncertainty caused by pandemic

Chart 31 EMBI risk premium
(basis points, daily values)

*Until May 8, 2020

- After Serbia’s risk premium reached its historical low in December, and recorded the biggest fall in the region in 2019, corona virus pandemic and increased uncertainty on international financial market caused the rise in the risk premia of emerging markets since the beginning of 2020, including Serbia. Though, EMBI for Serbia is still far below EMBI Global Composite.

- Since the beginning of 2020, both Fitch (March) and S&P (May) affirmed Serbia’s rating at BB+, despite global crisis caused by COVID-19 pandemic.

The dinar maintained relative stability against the euro

Chart 32 Exchange rate developments
(31 December 2012 = 100)

* + net purchase; - net sale.
** EUR 1 in RSD.

*In the previous three years the dinar cumulatively appreciated by 5% against the euro in nominal terms. Strengthening of the dinar is stimulated by better Serbia’s macroeconomic fundamentals, good performance and favorable growth prospects, which contributed to FX inflow on account of FDI and elevated non-resident investment in long-term dinar government securities. Since the beginning of 2020, the dinar stayed broadly unchanged against the euro.

*In order to maintain the relative stability of the dinar, the National Bank of Serbia was buying FX in periods of strong and concentrated appreciation pressures, acting proactively and bolstering the FX reserves, thus enhancing the resilience of the domestic financial system to external risks and creating space to act when they materialize.
Indicators of Dinarisation are on the Rise

Macroeconomic stability contributing to dinarisation process

The growth of dinar loans to households accompanied by higher dinar savings

• NBS stimulates the dinarisation process by delivering low and stable inflation, preserving relative exchange rate stability, enhancing management of FX risks and exposures in the private sector, and using other measures.

• The Government contributes to dinarisation through tax policy, by developing the dinar securities market (dinar debt share rose from 2.5% in 2008 to 28.8% in March 2020).

• Dinarisation of corporate and household sector deposits rose by 16.3 pp compared to end-2012 and currently stands at 35.6% (March 2020), while dinarisation of corporate and household sector receivables rose by 5.2 pp to 33.2% (March 2020).

• Over the past years, dinarisation of household receivables had a firm upward trend as a result of a sharp drop in dinar interest rates, low and stable inflation as well as NBS measures aimed to support dinarisation – an upsurge from 35.1% (2012) to 55.1% (March 2020).

• Dinar savings of households (residents) recorded strong growth in past two years (22.2% in 2018 and 30.7% in 2019), which is also continued in 2020 (in Q1 it increased by RSD 4.1 bn).

• Preserved confidence in the banking system during the crisis is evidenced by the preliminary data for April, indicating further growth in household savings.
Traditional Banking
Mostly Financed by Domestic Deposits

Adequate structure of banking sector assets

Chart 35 Structure of banking sector assets
(RSD bn)

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash and assets with central bank</th>
<th>Securities</th>
<th>Loans</th>
<th>Other</th>
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<tr>
<td>2013</td>
<td>50%</td>
<td>68%</td>
<td>61%</td>
<td>365.8</td>
</tr>
<tr>
<td>2014</td>
<td>50%</td>
<td>68%</td>
<td>61%</td>
<td>345.8</td>
</tr>
<tr>
<td>2015</td>
<td>50%</td>
<td>68%</td>
<td>61%</td>
<td>103.1</td>
</tr>
<tr>
<td>2016</td>
<td>50%</td>
<td>68%</td>
<td>61%</td>
<td>18.63%</td>
</tr>
<tr>
<td>2017</td>
<td>50%</td>
<td>68%</td>
<td>61%</td>
<td>17.03%</td>
</tr>
<tr>
<td>2018</td>
<td>50%</td>
<td>68%</td>
<td>61%</td>
<td>4.02%</td>
</tr>
<tr>
<td>2019</td>
<td>50%</td>
<td>68%</td>
<td>61%</td>
<td>103.1</td>
</tr>
<tr>
<td>2020</td>
<td>50%</td>
<td>68%</td>
<td>61%</td>
<td>61%</td>
</tr>
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Source: NBS

• Risk aversion during the crisis led to more intensive investments in low-risk state securities, which after 2015 stabilized at around of one-fifth of the total banking sector net assets (17.2% at the end of March 2020).

• Despite historical low levels of deposit rates, stability of retail and corporate deposits in funding mix is present, with share in total liabilities of 46% and 27%, respectively at the end of March 2020.

• Despite high loan portfolio euroization, currency matching of assets and liabilities is present, with net open position of 1.0% of regulatory capital at end of March 2020.

Improving the quality of the banking sector assets

Chart 36 Asset quality – Non-performing loans (NPL)
(RSD bn, %)

• Implementation of NPLs resolution measures together with the growth of credit activity led to a significant improvement of banks portfolio quality. The share of NPLs decreased to the lowest level since the 2008 when the definition and reporting requirements were introduced.

• At end-March 2020, the NPL ratio was 4.0%, with the maintenance of relatively high coverage by both, IFRS provisions (61.4%).

• The main channels for the NPLs reduction remained the write-off and transfer (sale) to third parties, with increasing contribution of repayment.
Conservative Framework Contributed to the Banking Sector Resilience to Shocks

High banking sector capitalisation as a result of strong prudential measures

- Banks possess significant capital reserves, which enable them to successfully deal with credit risk even in the case of worst-case stress scenario.
- In addition to the high level, the capitalization of the banking sector is characterized by a strong structure, with CET1 around 95% of total capital.
- The high solvency of the banking sector is also indicated by the leverage ratio, introduced in regulatory framework of the Republic of Serbia with Basel III implementation, which at the end of March 2020 amounted to 13.2%.

Serbian banking sector is highly liquid

- Liquidity ratios are constantly at levels significantly higher than the regulatory minimum.
- Liquid assets account for around 35.9% of the total assets of the banking sector in March 2020.
- The loan to deposit ratio that at the end of March 2020 amounted 93.2%, indicates stability of funding and in general the liquidity of the banking sector.
Structural slides
Improved Structural Competitiveness Provided Additional Boost to Overall Macroeconomic Performance

Key reform areas in the last four years:

- Construction sector;
- Labor market;
- Tax administration;
- Financial sector;
- Contract enforcement and resolving insolvency.

Chart 39 Indicators on business regulation, Doing Business
(rank, lower value means rank improvement)

Chart 40 Global competitiveness indicators, WEF
(rank, lower value means rank improvement)


Domestic regulatory framework for banking supervision is based on Basel III standards:

- Set of by-laws implementing these standards on individual and consolidated level are applied as of 30 June 2017;
- Since July 2017 further steps on harmonization of domestic legal framework with Basel III were made;
- The main goals of implementing these standards are to increase the resilience of the banking sector by enhancing the quality of capital and introducing capital buffers, to increase the efficiency of monitoring and controlling banks’ exposure to liquidity risk, further strengthening of the market discipline and transparency of banks’ operation in the Republic of Serbia by publishing all relevant information on bank operation, as well as to bring the reporting system in line with the new regulatory arrangements
- So far no issues have been identified in the application of Basel III standards;
- NBS will continue to take regulatory activities in order to ensure alignment with EU acquis.

In December 2017 regulation governing risk management by banks was amended with aim to improve the way bank deals with risks and enhance its Internal Capital Adequacy Assessment Process (ICAAP).

Accounting and prudential regulations were timely adjusted in order to enable the implementation of IFRS 9 in banks from 1st of January 2018.

Additionally, cooperation with supervisors of the home countries of banks present in Serbia is continuously developing and strengthening and regular communication with the ECB and EBA is maintained.
The Amendment of NPL Resolution Strategy by adoption of NPL Program for period 2018 - 2020

Effect of strategy on NPL stock

Chart 41 Gross NPL (RSD bn)

- Aggregate decrease of NPL level in August 2015 – February 2020 amounts to RSD 324.2 bn, while the effect of the NPL Strategy is mostly reflected through the historically lowest level of NPL ratio of 4.0% at end-March 2020. Compared with NPL ratio before the NPL Strategy entered into the force (22.25%) the decrease is clearly impressive at 18.23 p.p.

- Beside successful implementation of NPL Strategy, it is necessary to perform activities intended for resolution of remaining problems in order to provide the sustainability of achieved results. For that purpose, it is very important to create the ambient, which strives for early detection of sources and causes of NPLs, as well as, upgrading of existing institutes directed toward resolution of potentially new NPLs. Bearing that in mind, the Government of the Republic of Serbia on the December 27th 2018 implemented a Program for NPL resolution for period of 2018 – 2020 (Program for NPL).

- As a integral part of Program for NPL, Action plan focuses on subjects of:
  - resolution of non-performing claims of state-owned financial creditors, through assignment of claims and eventually write-off of remaining part of portfolio;
  - improving bankruptcy framework, i.e. it’s upgrade as institute in non-performing claims resolution;
  - series of activities that are directed to the prevention of emerging and accumulating of new NPLs.

Effect of strategy on NPL ratio

Chart 42 NPL Ratio (in %)

Source: NBS
Capital Buffers – Implementation of Macroprudential Policy Measures

- Capital buffers increase the resilience of banks to losses, reduce excessive or underestimated exposures and restrict the distribution of capital.
- These macroprudential instruments should limit systemic risks in the financial system, which can be cyclical (capital conservation buffer and countercyclical capital buffer) or structural (capital buffer for a systemically important bank and systemic risk buffer).
- The following capital buffers are used in the Republic of Serbia:
  - Capital conservation buffer;
  - Countercyclical capital buffer, in order to mitigate and prevent excessive credit growth;
  - Capital buffer for a systemically important bank, with the objective to limit the systemic impact of misaligned incentives in terms of favoring certain financial institutions;
  - Systemic risk buffer, introduced to limit the risk of euroisation, one of the key structural non-cyclical systemic risks to the stability of the financial system of the Republic of Serbia.
- The capital conservation buffers may consist only of Common Equity Tier 1 capital equal to 2.5% risk-weighted assets for capital conservation buffer, 1% or 2% risk-weighted assets for capital buffer for systemically important banks, depending on the systemic importance level and 3% of total foreign currency and foreign currency-indexed placements of a bank approved to corporates and households in the Republic of Serbia for systemic risk buffer. Countercyclical buffer rate is set at 0%.
- Capital buffers apply as of 30 June 2017.
NPL Resolution Required a Systemic Approach – and, as Such, Gave Results

- NPL development after the adoption of the NPL Resolution Strategy, especially in 2017, 2018 and 2019, confirmed the soundness of the inter-institutional and coordinated approach envisaged by the Strategy.

- After 2019 drop in share of NPLs of 1.61 pp, noticeable downward trend had slow downed in 2020, resulting with four times lower NPL ratio than it was at the time of Strategy adoption.

- Fall was widespread and recorded in all sectors, of which most prominent was within construction.

- The continuation of NPL resolution efforts by banks together with the recovery of credit activity, should further stimulate the decrease in the share of NPLs.

<table>
<thead>
<tr>
<th>NPL data, March 2020</th>
<th>Gross loans (EUR bn)</th>
<th>Gross NPL (EUR bn)</th>
<th>NPL ratio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporates</td>
<td>9.9</td>
<td>0.3</td>
<td>3.3</td>
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<tr>
<td>Natural persons</td>
<td>9.6</td>
<td>0.4</td>
<td>4.1</td>
</tr>
<tr>
<td>of which: households</td>
<td>8.6</td>
<td>0.4</td>
<td>4.1</td>
</tr>
<tr>
<td>Corporates in bankruptcy proceedings</td>
<td>0.1</td>
<td>0.1</td>
<td>98.6</td>
</tr>
<tr>
<td>Other</td>
<td>2.2</td>
<td>0.1</td>
<td>4.5</td>
</tr>
<tr>
<td>Total</td>
<td>21.8</td>
<td>0.9</td>
<td>4.0</td>
</tr>
</tbody>
</table>
## Serbia’s Economic Outlook

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>Real GDP, y-o-y %</strong></td>
<td>5.7</td>
<td>-2.7</td>
<td>0.7</td>
<td>2.0</td>
<td>-0.7</td>
<td>2.9</td>
<td>-1.6</td>
<td>1.8</td>
<td>3.3</td>
<td>2.0</td>
<td>4.4</td>
<td>4.2</td>
<td>-1.5</td>
<td>6.0</td>
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<tr>
<td><strong>Private consumption, in %</strong></td>
<td>4.5</td>
<td>-3.3</td>
<td>-0.6</td>
<td>1.4</td>
<td>-1.7</td>
<td>-1.7</td>
<td>-0.1</td>
<td>-0.3</td>
<td>1.3</td>
<td>1.9</td>
<td>3.1</td>
<td>3.2</td>
<td>-1.9</td>
<td>5.1</td>
</tr>
<tr>
<td><strong>Private investment,(^1) in %</strong></td>
<td>14.4</td>
<td>-23.6</td>
<td>-7.9</td>
<td>7.5</td>
<td>15.1</td>
<td>-7.7</td>
<td>-5.6</td>
<td>3.5</td>
<td>2.7</td>
<td>10.1</td>
<td>13.6</td>
<td>13.4</td>
<td>-5.2</td>
<td>10.7</td>
</tr>
<tr>
<td><strong>Government consumption, in %</strong></td>
<td>3.5</td>
<td>-1.7</td>
<td>0.0</td>
<td>1.6</td>
<td>0.4</td>
<td>-2.1</td>
<td>0.9</td>
<td>-3.8</td>
<td>1.3</td>
<td>3.3</td>
<td>3.7</td>
<td>3.0</td>
<td>2.4</td>
<td>2.0</td>
</tr>
<tr>
<td><strong>Government investment, in %</strong></td>
<td>-16.4</td>
<td>-16.6</td>
<td>0.0</td>
<td>-7.8</td>
<td>7.6</td>
<td>-35.8</td>
<td>13.6</td>
<td>14.0</td>
<td>22.0</td>
<td>-6.4</td>
<td>43.1</td>
<td>30.4</td>
<td>-17.0</td>
<td>26.6</td>
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<tr>
<td><strong>Exports, in %</strong></td>
<td>12.6</td>
<td>-11.5</td>
<td>16.9</td>
<td>5.6</td>
<td>2.9</td>
<td>18.0</td>
<td>4.3</td>
<td>9.4</td>
<td>11.9</td>
<td>8.2</td>
<td>8.3</td>
<td>8.5</td>
<td>-1.9</td>
<td>13.2</td>
</tr>
<tr>
<td><strong>Imports, in %</strong></td>
<td>10.1</td>
<td>-21.9</td>
<td>-0.1</td>
<td>7.2</td>
<td>-0.6</td>
<td>6.5</td>
<td>5.1</td>
<td>4.0</td>
<td>6.7</td>
<td>11.1</td>
<td>11.6</td>
<td>9.5</td>
<td>-4.4</td>
<td>13.2</td>
</tr>
<tr>
<td><strong>Unemployment Rate, in %(^4)</strong></td>
<td>13.6</td>
<td>16.1</td>
<td>19.2</td>
<td>23.0</td>
<td>23.9</td>
<td>22.1</td>
<td>19.2</td>
<td>17.7</td>
<td>15.3</td>
<td>13.5</td>
<td>12.7</td>
<td>10.4</td>
<td>-</td>
<td>-</td>
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<tr>
<td><strong>Nominal Wages, in %(^5)</strong></td>
<td>18.0</td>
<td>9.0</td>
<td>7.6</td>
<td>11.2</td>
<td>9.0</td>
<td>6.2</td>
<td>1.4</td>
<td>-0.2</td>
<td>3.7</td>
<td>3.9</td>
<td>6.5</td>
<td>10.6</td>
<td>-</td>
<td>-</td>
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<tr>
<td><strong>Money Supply (M3), in %</strong></td>
<td>9.8</td>
<td>21.5</td>
<td>12.9</td>
<td>10.3</td>
<td>9.4</td>
<td>4.6</td>
<td>7.6</td>
<td>6.6</td>
<td>11.6</td>
<td>3.6</td>
<td>14.5</td>
<td>8.4</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>CPI,(^2) in %</strong></td>
<td>8.6</td>
<td>6.6</td>
<td>10.3</td>
<td>7.0</td>
<td>12.2</td>
<td>2.2</td>
<td>1.7</td>
<td>1.5</td>
<td>1.6</td>
<td>3.0</td>
<td>2.0</td>
<td>1.9</td>
<td>1.5</td>
<td>1.8</td>
</tr>
<tr>
<td><strong>National Bank of Serbia Key Policy Rate,(^3) in %</strong></td>
<td>17.8</td>
<td>9.5</td>
<td>11.5</td>
<td>9.8</td>
<td>11.3</td>
<td>9.5</td>
<td>8.0</td>
<td>4.5</td>
<td>4.0</td>
<td>3.5</td>
<td>3.0</td>
<td>2.25</td>
<td>1.50</td>
<td>-</td>
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<tr>
<td><strong>Current Account Deficit BPM-6 (% of GDP)</strong></td>
<td>20.0</td>
<td>6.3</td>
<td>6.5</td>
<td>10.3</td>
<td>10.9</td>
<td>5.8</td>
<td>5.6</td>
<td>3.5</td>
<td>2.9</td>
<td>5.2</td>
<td>4.8</td>
<td>6.9</td>
<td>5.0</td>
<td>5.5</td>
</tr>
</tbody>
</table>

\(^1\) Excluding the effect of change in inventories
\(^2\) Inflation figures in the table represent Dec on Dec inflation: \((P_t/P_{t-12})\times100-100\)
\(^3\) Latest data
\(^4\) Labour Force Survey. Since 2014, data are revised according to the new LFS methodology. Data for 2019 are calculated as average of four quarters.
\(^5\) Since 2017, nominal wages published according to the new methodology.
# Banking Sector Overview

**March 2019**

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td><strong>Number of banks</strong></td>
<td>33</td>
<td>32</td>
<td>30</td>
<td>29</td>
<td>30</td>
<td>31</td>
<td>29</td>
<td>27</td>
<td>26</td>
<td>26</td>
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<tr>
<td><strong>Employees</strong></td>
<td>29,228</td>
<td>28,394</td>
<td>26,380</td>
<td>25,106</td>
<td>24,257</td>
<td>23,847</td>
<td>23,055</td>
<td>22,830</td>
<td>23,087</td>
<td>23,117</td>
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<tr>
<td><strong>Branches</strong></td>
<td>2,383</td>
<td>2,243</td>
<td>1,989</td>
<td>1,787</td>
<td>1,730</td>
<td>1,719</td>
<td>1,700</td>
<td>1,627</td>
<td>1,598</td>
<td>1,589</td>
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<tr>
<td><strong>HHI Assets</strong></td>
<td>664</td>
<td>678</td>
<td>741</td>
<td>794</td>
<td>813</td>
<td>813</td>
<td>779</td>
<td>800</td>
<td>795</td>
<td></td>
</tr>
<tr>
<td><strong>Share of foreign banks, %</strong></td>
<td>74.1</td>
<td>75.2</td>
<td>74.3</td>
<td>74.5</td>
<td>76.1</td>
<td>76.7</td>
<td>76.9</td>
<td>75.4</td>
<td>75.7</td>
<td>75.5</td>
</tr>
<tr>
<td><strong>Assets (net), EUR m</strong></td>
<td>25,211</td>
<td>25,322</td>
<td>24,827</td>
<td>24,545</td>
<td>25,059</td>
<td>26,253</td>
<td>28,440</td>
<td>31,931</td>
<td>34,731</td>
<td>35,513</td>
</tr>
<tr>
<td><strong>Capital, EUR m</strong></td>
<td>5,104</td>
<td>5,198</td>
<td>5,186</td>
<td>5,186</td>
<td>5,122</td>
<td>5,122</td>
<td>5,631</td>
<td>5,725</td>
<td>6,002</td>
<td>6,034</td>
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<tr>
<td><strong>Loans (gross), EUR m</strong></td>
<td>17,204</td>
<td>17,273</td>
<td>16,140</td>
<td>16,170</td>
<td>16,175</td>
<td>16,442</td>
<td>17,565</td>
<td>19,406</td>
<td>21,111</td>
<td>21,835</td>
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<tr>
<td>Of which gross NPL, EUR m</td>
<td>3,275</td>
<td>3,217</td>
<td>3,448</td>
<td>3,483</td>
<td>3,491</td>
<td>2,800</td>
<td>1,730</td>
<td>1,105</td>
<td>862</td>
<td>877</td>
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<tr>
<td><strong>Gross NPL ratio, %</strong></td>
<td>19.0</td>
<td>18.6</td>
<td>21.4</td>
<td>21.5</td>
<td>21.6</td>
<td>17.0</td>
<td>9.8</td>
<td>5.7</td>
<td>4.1</td>
<td>4.0</td>
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<tr>
<td><strong>IFRS impairment of NPLs</strong></td>
<td>51.0</td>
<td>50.0</td>
<td>50.9</td>
<td>54.9</td>
<td>62.3</td>
<td>67.8</td>
<td>58.1</td>
<td>60.2</td>
<td>61.5</td>
<td>61.4</td>
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<tr>
<td><strong>Deposits, EUR m</strong></td>
<td>14,584</td>
<td>14,936</td>
<td>15,067</td>
<td>15,637</td>
<td>16,523</td>
<td>18,242</td>
<td>19,926</td>
<td>23,115</td>
<td>25,197</td>
<td>25,535</td>
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<td><strong>Pretax Income</strong>, EUR m</td>
<td>12.0</td>
<td>102.5</td>
<td>-18.0</td>
<td>29.0</td>
<td>80.0</td>
<td>172.0</td>
<td>579.8</td>
<td>640.6</td>
<td>575.5</td>
<td>158.8</td>
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<td><strong>CAR</strong></td>
<td>19.1</td>
<td>19.9</td>
<td>20.9</td>
<td>20.0</td>
<td>20.9</td>
<td>21.8</td>
<td>22.6</td>
<td>22.3</td>
<td>23.4</td>
<td>22.7</td>
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<tr>
<td><strong>CET1 ratio</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>21.5</td>
<td>21.1</td>
<td>22.3</td>
<td>21.8</td>
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<td><strong>Leverage</strong></td>
<td>-</td>
<td>-</td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>11.1</td>
<td>12.6</td>
<td>13.6</td>
<td>13.2</td>
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<tr>
<td><strong>Liquidity ratio</strong></td>
<td>2.2</td>
<td>2.1</td>
<td>2.4</td>
<td>2.2</td>
<td>2.1</td>
<td>2.1</td>
<td>2.0</td>
<td>2.0</td>
<td>2.2</td>
<td>2.2</td>
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<tr>
<td><strong>Liquidity coverage ratio</strong></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>239.5</td>
<td>213.3</td>
<td>199.3</td>
<td>190.7</td>
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<td><strong>FX ratio</strong></td>
<td>6.2</td>
<td>5.5</td>
<td>4.4</td>
<td>3.9</td>
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<td>2.9</td>
<td>4.5</td>
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<td><strong>ROA</strong></td>
<td>0.0</td>
<td>0.4</td>
<td>-0.1</td>
<td>0.1</td>
<td>0.3</td>
<td>0.7</td>
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<td><strong>ROE</strong></td>
<td>0.2</td>
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<td>-0.4</td>
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<td>1.6</td>
<td>3.4</td>
<td>10.6</td>
<td>11.3</td>
<td>9.8</td>
<td>10.5</td>
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<tr>
<td><strong>Net interest margin</strong></td>
<td>4.6</td>
<td>4.3</td>
<td>4.2</td>
<td>4.3</td>
<td>4.3</td>
<td>3.9</td>
<td>3.7</td>
<td>3.6</td>
<td>3.3</td>
<td>3.1</td>
</tr>
</tbody>
</table>

1. The NBS revoked operating licence from Nova Agrobanka on 27 October 2012, from Razvojna banka Vojvodina on 6 April 2013, from Privredna banka Beograd on 26 October 2013, from Univerzal banka Beograd on 31 January 2014 and from Jugobank Jugbank Kosovska Mitrovica on 2 April 2018. The NBS issued operating licence to Mrabank on 16 December 2014 and the bank started its operations in April 2015. The NBS issued operating licence to Bank of China Srbija on 20 December 2016. The Findomestic bank was merged to Direktna bank on 1 July, 2017. Jubanka ad Beograd was merged to AIK Bank on 23 December, 2017. Piraeus bank was merged to Direktna bank on 26 October, 2018. Vojvodanska bank was merged to OTP bank 25. April 2019 (consolidated under Vojvodanska brand).

2. Without Agrobanka at the end of 2011: Pretax profit € 296m; ROA 1.2; ROE 6.0. Without Razvojna banka Vojvodina at the end of 2012: Pretax profit € 230m; ROA 1.0; ROE 4.7

3. The last available data of 31.03.2020

4. Introduced by the implementation of Basel 3 and monitored from 30 June 2017

5. Net interest margin to average total asset

6. The NBS revoked operating licence from Nova Agrobanka on 27 October 2012, from Razvojna banka Vojvodina on 6 April 2013, from Privredna banka Beograd on 26 October 2013, from Univerzal banka Beograd on 31 January 2014 and from Jugobank Jugbank Kosovska Mitrovica on 2 April 2018. The NBS issued operating licence to Mrabank on 16 December 2014 and the bank started its operations in April 2015. The NBS issued operating licence to Bank of China Srbija on 20 December 2016. The Findomestic bank was merged to Direktna bank on 1 July, 2017. Jubanka ad Beograd was merged to AIK Bank on 23 December, 2017. Piraeus bank was merged to Direktna bank on 26 October, 2018. Vojvodanska bank was merged to OTP bank 25. April 2019 (consolidated under Vojvodanska brand).